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AUTHORITIES CITED

In the Supreme Court of the United States

OCTOBER TERM, 1925

No. 29

THE UNITED STATES, APPELLANT

v.

BOSTON INSURANCE COMPANY

APPEAL FROM THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

This is an appeal, pursuant to Section 242 of the Judicial Code, from a judgment of the Court of Claims entered on November 5, 1923. The opinion of that court is reported in 58 Ct. Cls. 603, and is found at page 10 of the record. The application for appeal was filed January 7, 1924, and allowed January 14, 1924. (R. 14.) The judgment awards the appellee, hereinafter called the plaintiff, the sum of $8,755.92, with interest, and was based upon findings of fact made after trial.

The suit was to recover the amount of a tax alleged to have been illegally assessed after claim for refund had been made and rejected.

STATEMENT OF THE CASE

The plaintiff is a fire and marine insurance corporation of Massachusetts. (Finding I, R. 4.)

It was duly authorized to do business in various States, including the State of New York, and the question presented relates to its taxable income for the year 1916.

THE ISSUE

The specific question involved is the right of the plaintiff to deduct from its gross income for the year 1916 the sum of $560,678.43, being the excess of its so-called unsettled loss claims, shown by its report for that year, over the amount shown by its report for the preceding year, and the question arises under Sections 10 and 12 of Title I of the Revenue Act of 1916, ch. 463, 39 Stats. 756, 765, 767.

THE STATUTE

The following are the relevant portions of the statute:

> SEC. 10. That there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized but not including partnerships, a tax of two per centum upon such income; * * *
>
> SEC. 12. (a) In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the gross amount of its

income received within the year from all sources—

First. All the ordinary and necessary expenses paid within the year * * *.

Second. All losses actually sustained and charged off within the year and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade; * * * (c) in the case of insurance companies, the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts: * * *.

The question arises particularly under subdivision (c), which is in all essentials similar to corresponding provisions in the Corporation Excise Tax Law of 1909, Act of August 5, 1909, ch. 6, 36 Stats. 11, 1913, and the Revenue Act of 1913, Act of October 3, 1913, ch. 16, 38 Stats. 114, 166.[1]

[1] The Bill which became the Revenue Act of 1916 was introduced in the House as H. R. No. 16763, 64th Congress, First Session, and contained the provision relating to reserve funds which we are now considering. See Congressional Record, 64th Congress, First Session, Part 11, Vol. 53, p. 10666. The Bill as reported to the Senate did not contain this provision. Senator Sherman called the attention of the Senate to the failure of the Bill as reported to make allowance for the deduction of reserve funds, as provided in the original Bill, and commented vigorously upon this omission. He said:

"Conceive for a moment of the infinite injustice of permitting this provision to stand stricken out. I prefer to think it was an oversight and was inadvertently omitted * * *. What are these net additions to the reserve each year? An elementary knowledge of life

The claim of the plaintiff, which was sustained by the Court of Claims, was that the sum of $560,678.43 was, within the meaning of the Statute, a "net addition required by law to be made within the year to reserve funds," under the Insurance Law of the State of New York. The contention of the Government is that it was not part of the "reserve funds" within the meaning of the Statute. The Court of Claims, in the Sixth Finding (R. 5 and 6), found:

VI

> The failure and refusal of the Commissioner of Internal Revenue to treat as reserve funds required by law the funds held, set aside, and retained by plaintiff in the amount and on account of its liabilities for unsettled loss claims and to deduct from plaintiff's gross income the net addition to such funds during the year 1916, amounting to $560,678.43, resulted in the rejection of $8,755.92 of the amount requested to be

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insurance is all that is necessary, I think, to show the fairness of such an exemption."

He went on to explain the nature of insurance reserves, and said:

"The laws of New York, the laws of Massachusetts, the laws of Pennsylvania, the laws of Ohio, the laws of Illinois, the laws of every state that I ever had an occasion to investigate, require, if I pay, for instance, $35.00 premium on a thousand at my age, a certain proportion of that to be set aside as a reserve. What for? For the guaranty of the performance of the promise to pay my policy when the event happens."

See pages 13091 and 13092, Congressional Record, 64th Congress, First Session, Vol. 53, Part 13. The omitted portion was put back in the Bill by the Conference Committee, being amendment 74, Conference Report No. 1200, and became a part of the Act as finally passed. House Reports, Vol. 3, 64th Congress, First Session, p. 29.

refunded in plaintiff's said refunding claim. Plaintiff in this suit is seeking to recover the amount so rejected with accrued interest thereon.

The net addition of $560,678.43 was obtained by deducting the reserve for loss claims plaintiff was required to maintain on December 31, 1915, $775,900.10, as a condition precedent to the transaction of business in the State of New York for 1916 from the reserve fund plaintiff was required to maintain on December 31, 1916, $1,336,578.53, as a condition precedent to the transaction of business in 1917 in the State of New York.

And in the Eighth Finding (R. 9):

VIII

The superintendent of insurance for the State of New York during the years 1915, 1916, and 1917 required stock, fire, and marine insurance companies, and stock, casualty, surety, and credit insurance companies, as a condition precedent to the transaction of business in the State of New York, to maintain reserves to cover the following liabilities:

"Stock, fire, and marine insurance companies

"A. Loss reserve, including all unpaid losses and estimated expense of investigations and adjustment thereof, less admitted reinsurance.

"B. Reserve for unearned premiums as required by statute and departmental regulations, i. e., (*a*) on fire-insurance risks a sum equal to the actual unearned premium on the policies in force calculated on the gross sum without any deduction except for admitted reinsurance, and (*b*) on marine hull risks calculated in the same manner and on marine cargo risks 100 per cent of the last month's gross premium writings.

"C. Reserve for all other outstanding liabilities due or accrued.

"Stock, casualty, surety, and credit insurance companies

"A. Loss reserve, including all unpaid losses and estimated expense of investigation and adjustment thereof, whether on account of compensation and liability insurance or otherwise, less admitted reinsurance, and such additional contingent reserves for losses as may be required by the superintendent of insurance.

"B. Unearned premium or reinsurance reserve calculated as required by statute and all premiums paid in advance at 100 per cent.

"C. Reserve for all other outstanding liabilities due or accrued."

And in the Tenth Finding (R. 10):

X

The funds to meet the liabilities of insurance companies were not required by the superintendent of insurance to be kept sep-

arate and distinct from other assets of such companies, but such funds were required to be separately specified by book entries as (1) reserves to meet liabilities for unearned premiums and (2) unpaid loss claims and (3) all other outstanding liabilities, due or accrued. All companies were required to have on hand at all times sufficient assets to meet all their liabilities.

THE CONTENTION OF THE UNITED STATES

The claim of the Government is that the so-called loss claims reserve of fire insurance companies is not a "reserve" within the meaning of the Statute or in the commonly accepted meaning of the word, but is a mere liability treated as such by the New York Insurance Law.

SYNOPSIS OF THE ARGUMENT

This case is controlled either by the case of *McCoach* v. *Insurance Company of North America,* 244 U. S. 585, or the case of *Maryland Casualty Company* v. *United States,* 251 U. S. 342.

Both involved the deductibility from gross income of so-called "loss claims reserves" in fixing net income under statutory provisions practically identical with that now under consideration.

In the *McCoach case* the deduction was *not* allowed to a fire and marine insurance company because it was held *not* to be a reserve required by law

In the *Maryland Casualty Company case* the deduction *was* allowed to a casualty insurance company because it was held *to be* a reserve required by law.

The principle which distinguishes the two cases lies in the difference between "reserves" of fire and marine insurance companies and those of casualty companies, a difference recognized by the State Insurance Laws.

The case at bar is a fire and marine insurance case.

The "reserve" to be considered is that required by the New York Insurance Laws to be maintained by fire and marine companies—not casualty companies.

The only reserve required of fire and marine companies by those laws is the "unearned premium reserve."

The fact that the New York statutes require all insurance companies to report all their liabilities, and insists that they be solvent as a condition of doing business in the State, does not change an ordinary liability to a "reserve required by law" within the meaning of the Revenue Act of 1916.

The *Maryland Casualty Company case* did not purport to overrule or question the authority of the *McCoach case*. There is no conflict between them, and upon the authority of the *McCoach case* the judgment of the Court below should be reversed.

ARGUMENT

I

The decision in McCoach v. Insurance Co. of North America, 244 U. S. 585, is controlling upon the issues in this case

The case of *McCoach* v. *Insurance Company of North America,* 244 U. S. 585, was an action brought by a fire and marine insurance company of Pennsylvania, to recover part of an excise tax assessed for the years 1910 and 1911, under the Act of August 5, 1909, ch. 6, Sec. 38, 36 Stats. 11, 112–113.

The only items in dispute before this Court were those representing the tax upon amounts added in each of those years to that part of what were called its "reserve funds," which were held against accrued but unpaid losses, the same issue presented in the case at bar. Section 38 of the Act provided that the net income upon which the tax was based should be ascertained by deducting from the gross income, among other things—

> * * * all losses actually sustained within the year and not compensated by insurance or otherwise * * * and in the case of insurance companies the sums other than dividends paid within the year on policy and annuity contracts *and the net addition, if any, required by law to be made within the year to reserve funds.*

This Court, using italics as above, stated the question to be decided as follows:

> The italics indicate the particular words upon which the controversy turns; the question being whether, within the meaning of the act of Congress, "reserve funds," with annual or occasional additions, are "required by law," in Pennsylvania to be maintained by fire and marine insurance companies, other than the "unearned premium" or "reinsurance reserve" known to the general law of insurance.

The court, proceeding to consider provisions of the Pennsylvania law, Act of June 1, 1911, P. L. 607, 608, found that it created a state insurance commissioner with supervisory control over the companies; provided that he should see that all laws of the commonwealth respecting insurance companies were faithfully executed; authorized him to make examinations; to have access to all the books and papers of any company; to examine witnesses relative to its affairs; to publish the result of his examination; to suspend the entire business of any company during its noncompliance with any provision of law or whenever he should find that its assets were insufficient to justify its continuance in business; and to communicate the facts to the Attorney General whenever he should find any company to be insolvent, fraudulently conducted, or its assets insufficient for carrying on its business. The law required every company to file annual statements with the commissioner upon blank forms to be furnished by him,

such as should seem to him best adapted to elicit a true exhibit of its financial condition.

Sections 7, 8, and 9 of the Pennsylvania Law, set forth in the margin of the report, 244 U. S. 587, 588, made specific provisions for ascertaining the reserve for different classes of companies other than life insurance companies. A previous act, April 4, 1873, P. L. 20, 22, required a specific reinsurance reserve against unexpired risks on fire, marine, and inland policies. The court said:

> The Act of 1911, just quoted, requires the maintenance of a substantially similar reserve; and, with respect to casualty companies and these only, that a reserve be maintained against unpaid losses, based upon the amount of claims presented.

Section 9 of the Act quoted in the margin, 244 U. S. 588, provided that, having charged as a liability—

> * * * reinsurance and loss reserves, as above defined for insurance companies of this Commonwealth other than life, and adding thereto all other debts and claims against the company, the commissioner shall, in case he finds the capital of the company impaired 20 per centum, give notice, etc.

This Court stated that under this legislation and previous statutes in force since 1873 the insurance commissioner had required the plaintiff and similar companies to return each year as an item, among other liabilities, the net amount of unpaid

losses and claims whether actually adjusted, in process of adjustment, or resisted; and although that practice had not been sanctioned by any decision of the Supreme Court of the State, it was relied upon as an administrative interpretation of the law. The court then said:

> Conceding full effect to this, it still does not answer the question whether the amounts required to be held against unpaid losses, in the case of fire and marine insurance companies, are held as "reserves," within the meaning of the Pennsylvania law or of the act of Congress, however they may be designated upon the official forms. As already appears, the Pennsylvania act specifically requires debts and claims of all kinds to be included in the statement of liabilities, and treats them as something distinct from reserves. The object is to exercise abundant caution to maintain the companies in a secure financial position.
>
> The act of Congress, on the other hand, deals with reserves not particularly in their bearing upon the solvency of the company, but as they aid in determining what part of the gross income ought to be treated as net income for purposes of taxation. There is a specific provision for deducting "all losses actually sustained within the year and not compensated by insurance or otherwise." And this is a sufficient indication that losses in immediate contemplation, but not as yet actually sustained, were not intended to be treated as part of the reserve

> funds; that term rather having reference to the funds ordinarily held as against the contingent liability on outstanding policies.
>
> In our opinion the reserve against unpaid losses is not "required by law," in Pennsylvania, within the meaning of the act of Congress.

The analogy between this case and the case at bar is perfect. In each case the company is a fire and marine insurance company. The relevant portions of the Revenue Act of 1916 are similar, practically word for word, to the corresponding provisions of the Excise Tax Act of 1909. The provisions of the insurance law of New York, Chap. 28, Consolidated Laws, relating to the powers of the superintendent of insurance, are practically the same as those of the law of Pennsylvania, referred to by this court, relating to the insurance commissioner of that State. In each case it is his duty to see that the laws of the State with respect to insurance companies are faithfully executed. He is empowered to make examinations; to have access to all the books, papers, etc., of any company; to suspend business of a company if it violates the law; and each company is required to file annual statements upon blanks furnished by him such as shall seem to him best adapted to elicit a true exhibit of its financial condition.

The only reserve required of fire-insurance companies by the New York law is the unearned premium reserve.

As this Court said in the *Maryland Casualty Co. case,* 251 U. S. 342, the term reserve "has a special meaning in the law of insurance." In connection with fire insurance it has been applied ever since the year 1837 to the unearned premium fund (see *Yale Readings on Insurance—Fire,* p. 23), and, so far as we have been able to discover, to that alone. In connection with life insurance it is usually called the "net value" of the policy. (See *Eldrige's Principles of Reservation in their application to Legislative Regulation of Life Insurance.*) In casualty and liability insurance it has a broader meaning, including an amount fixed in a more or less arbitrary way to cover the contingent liability for each suit brought or claim made under each policy.

The New York statute contains specific provisions for estimating the legal reserve for the different kinds of companies. Section 118 of the New York Insurance Law, Ch. 28, Consolidated Laws, provides as follows:

> SEC. 118. *Allowance of assets and estimation of liabilities upon examinations.*— When an examination is made by the authority of the superintendent of insurance into the affairs of any fire insurance corporation doing business in this state, or when such corporation renders a statement

> to the insurance department, there shall not be allowed as assets any investments which are not held as prescribed by law at the date of such examination or rendering such statement; but unpaid premiums on policies written within three months shall be admitted as available resources. In estimating its liabilities, there shall be charged, in addition to the capital stock and all outstanding claims, a sum equal to the total unearned premiums on the policies in force, calculated on the gross sum without any deduction on any account, charged to the policyholder on each respective risk from the date of the issue of the policy.

It is to be observed that by this section, whenever an examination is made or a report rendered, in estimating liabilities there shall be included (1) capital stock, (2) all outstanding claims, and (3) a sum equal to unearned premiums, that is, the "reserve."

Article II of the New York Insurance Law deals with life, health, and casualty insurance corporations, and Section 86, a part of that article, provides for ascertaining the assets and liabilities of life and casualty insurance corporations. Under this section, in estimating the condition of a life insurance corporation, there shall be charged as liabilities—

> * * * in addition to the capital stock, all outstanding indebtedness of the corporation, and the premium reserve on policies,

> and additions thereto in force, computed according to the table of mortality and rate of interest prescribed in this article.

A preceding section, Section 84, prescribes in detail the method of "valuation" of life-insurance policies, that is, of computing the "premium reserve."

Section 86, prior to 1917, provided that in estimating the condition of any casualty insurance company there shall be charged as liabilities—

> * * * in addition to the capital stock, all outstanding indebtedness of the corporation, and the premium reserve on policies in force, equal to the unearned portions of the gross premiums charged for covering the risks, computed on each respective risk from the date of the issuance of the policy.

And further provides for computing the "indebtedness for outstanding losses" from accidents under Employers' Liability and General Liability clauses. These provisions are long and complicated, but they may be summarized by saying that they are based upon the ratio between losses and premiums, as shown by experience extending over a number of years.

Section 86 of the Insurance Law, as amended by chapter 298 of the laws of 1917, required that in estimating the condition of any casualty or surety insurance corporation there should be charged as liabilities, in addition to the capital stock:

> A. The premium reserve on policies in force, equal to the unearned portions of the gross premiums charged for covering the risks, computed on each respective risk from the date of the issuance of the policy.
>
> B. The reserve for outstanding losses under insurance against loss or damage from accident to or injuries suffered by an employee or other person and for which the insured is liable, computed as follows: * * *

Then follow specific directions for the computation of reserves; for instance, a reserve of $1,500 for each suit being defended under a policy written ten years prior to the date as of which the statement is made; $1,000 for each suit under a policy written five and not more than ten years prior, etc. Then follow directions as to compensation claims and the allocation of losses between different years. Finally it was provided:

> Whenever, in the judgment of the superintendent of insurance, the liability or compensation loss reserves of any insurer under his supervision, calculated in accordance with the foregoing provisions, are inadequate, he may, in his discretion, require such insurer to maintain additional reserves based upon estimated individual claims or otherwise.

Casualty companies, therefore, in addition to the unearned premium reserve, must maintain under their employees' and general liability poli-

cies a "loss-claims reserve," fixed arbitrarily by statute; and furthermore, if that reserve is, in the opinion of the Superintendent of Insurance, inadequate, he is empowered to require of any such company additional reserves. *He is given no power whatever to require a fire insurance company to maintain any reserve except the unearned premium reserve fixed by Section 118 of the Insurance Law.*

Indeed, he has no power to require them to report as liabilities any except the three enumerated in Section 118, capital stock, outstanding claims, and unearned premiums. (*Reports of the Attorney General of New York,* 1904, p. 413.) In that opinion the Attorney General of New York advised the superintendent of insurance with respect to the status of guaranty surplus funds and special reserve funds, under Sections 130, 131, and 132 of the Insurance Law, and particularly as to whether these funds should be reported under liabilities of the company. The sections of the Insurance Law referred to permitted companies to exercise an option to accumulate certain special funds the object of which was to provide additional security against extensive conflagrations.

The companies objected to being required to report these funds as liabilities, because the item designated in their reports as "surplus over all liabilities" was thereby reduced by an amount equal to the sum of these funds, and as the item

"surplus over all liabilities" was the principal item by which the financial strength of the corporation was estimated, the statement was unfair to the companies. It is obvious that under such circumstances a company maintaining this special fund would be in no better apparent condition than would a company which did not maintain it. The Attorney General recommended a modification of the ruling of the superintendent. In the course of his opinion the Attorney General said:

> Section 118 of the Insurance Law directs that in estimating the liabilities of the fire insurance corporation "there shall be charged, in addition to the capital stock and all outstanding claims, a sum equal to the total unearned premiums on the policies in force." The three items thus specified are all the items required by law to be enumerated and charged as liabilities, namely, capital stock, outstanding claims, and unearned premiums.

The portions of Section 118 of the Insurance Law quoted by the Attorney General is the same as was in force at the time of the transactions now being considered.

This "unearned premium reserve" is a trust fund, to be used only for purposes of reinsurance, or to be returned to the policyholder in case the company becomes insolvent. (*Reports of the Attorney General* of New York, 1906, page 558.) In that opinion, rendered by the Attorney General to the Superintendent of Insurance on December

19, 1906, he answered the three following questions in the affirmative:

> First. Is the receiver of an insolvent fire insurance company justified in using the unearned premium fund for the purposes of reinsurance or of restoring to the policyholders the unearned premium upon cancellation of their outstanding policies?
>
> Second. Are the policyholders in fire insurance companies preferred creditors to the extent of the unearned premiums upon their several uncanceled policies?
>
> Third. If the policyholders are preferred creditors to the extent of the unearned premiums, and a contract of reinsurance would simply cover the unearned premium fund, would the corporation still have the right, in contemplation of insolvency, to turn over that unearned premium fund in consideration of the reinsurance?

In reaching this conclusion he stated that in his opinion (p. 559):

> * * * the unearned premiums in the hands of the company thus paid in advance by the policyholder become in the hands of the company a trust fund, so far as the unearned portion is concerned, for the purpose of protecting the policyholder, either by reason of reinsurance or returning to him, the unearned premium. The company would have no right to use this unearned premium in the discharge of its other obligations to the detriment of the policy-

> holder, who has thus deposited it with the company.

Is it not plain, therefore, that with respect to fire insurance companies the only item treated as a reserve is the item of unearned premiums? All other obligations of the company, in addition to the capital stock, are considered "outstanding claims," though, for administrative purposes and in order to reflect the true condition of the company, the superintendent requires various kinds of outstanding claims to be divided and separately reported. It is obvious that the superintendent in passing upon the condition of a company and the manner in which it is conducting its business, should know the nature of its outstanding obligations, particularly the extent to which it is allowing its losses to remain unpaid.

The analogy to the *McCoach case* seems to be perfect. As this Court said in that case:

> The Pennsylvania act specifically requires debts and claims of all kinds to be included in the statement of liabilities and treats them as something distinct from reserves.

And that they could not be treated as reserves within the meaning of the Pennsylvania Law or of the Act of Congress, "however they may be designated upon the official forms." The amount of outstanding claims is in no sense a *reserve* required by law or departmental regulation. It is a *fact* with respect to an existing liability, not a re-

serve against the contingencies of the future, the term "reserve," as was said by this Court in the *McCoach case,* "having reference to the funds ordinarily held as against the contingent liability on outstanding policies."

II

The case of Maryland Casualty Co. v. The United States, 251 U. S. 342, does not control this case

The case of *Maryland Casualty Company* v. *The United States,* 251 U. S. 342, was an appeal from the Court of Claims. The suit was to recover certain taxes assessed under the Corporation Excise Tax Act of 1909, and the Income Tax Act of October 3, 1913, ch. 16, 38 Stats. 114, 166. The claimant was engaged in casualty, liability, fidelity, guaranty, and surety insurance. The larger part of its business was employers' liability, accident, and workmen's compensation insurance. Three questions were considered by this Court, but only one of them is relevant to the present discussion. That question was stated by the court as follows:

> May the amount of gross income of the claimant be reduced by the aggregate amount of the taxes, salaries, brokerage, and reinsurance unpaid at the end of each year, under the provisions in both the excise and income tax laws allowing deductions of "net addition, if any, required by law to be made within the year to reserve funds?"

The claimant in its returns treated as reserves the following items: "Reserve for unearned premiums," "special reserve for unpaid liability losses," and "loss claims reserve."

This Court said:

> Unearned premium reserve and special reserve for unpaid liability losses are familiar types of insurance reserves, and the Government, in its amended returns, allowed these two items, but rejected the third, "Loss claims reserve."
>
> The Court of Claims, somewhat obscurely, held that the third item should also be allowed. This "Loss claims reserve" was intended to provide for the liquidation of claims for unsettled losses (other than those provided for by the reserve for liability losses) which had accrued at the end of the tax year for which the return was made and the reserve computed. The finding that the Insurance Department of Pennsylvania, pursuant to statute, has at all times since and including 1909 required claimant to keep on hand, as a condition of doing business in that State, "assets as reserves sufficient to cover outstanding losses," justifies the deduction of this reserve as one required by law to be maintained, and the holding that it should have been allowed for all of the years involved is approved.

The specific finding of the Court of Claims, as shown by the record on file in this court, Finding XII, page 27 of the record, is as follows:

XII

The insurance department of the State of Pennsylvania, in which claimant does business, in pursuance of the act of 1873 (P. L. 20), and the act of May 1, 1876 (P. L. 53), the act of June 1, 1911 (P. L. 607) [Statutes of Pennsylvania], the latter act making no change in the department's rulings but more specifically defining them, has at all times since 1909, inclusive, required claimant to keep on hand, as a condition to its doing business in Pennsylvania, assets as reserves sufficient to cover outstanding losses, unearned premiums, and all other claims against the company, whether due or accrued.

The insurance department of the State of New York, in which claimant does business, made in pursuance of sections 86, 41, 39, 44, 45, 48 of the New York insurance laws of 1907, has at all times since 1909, inclusive, required claimant to maintain reserve funds sufficient in amount and satisfactory in kind to meet all of its accrued, but unpaid, indebtedness.

The insurance department of the State of Massachusetts in which claimant does business, in pursuance of section 87, chapter 576, acts of 1906, Massachusetts insurance laws, has at all times since 1909, inclusive, required claimant to hold or reserve assets for the payment of all claims and obligations against it.

> The insurance department of the State of Wisconsin in which claimant does business, in pursuance of section 1966–47 of the Wisconsin statutes of 1898, which authorize the commissioner of insurance in computing the reserve liability of casualty companies to make such computations as in his judgment are equitable and just to both policyholder and the company, has always since 1909, inclusive, required claimant to carry sufficient reserves to cover all of its outstanding liabilities, as set forth in its annual State reports.

It is to be observed that this Finding, with respect to the requirement of the Pennsylvania Insurance Department, is based upon the same statutes considered by this Court in the *McCoach case,* in which it was held that reserve funds held against accrued but unpaid losses in the case of *fire and marine insurance* companies under the Pennsylvania law, were not deductible under the Federal statute. In reaching that conclusion this Court pointed out that it was with respect to *casualty* companies only that the statute required a reserve against unpaid losses.

The Finding with respect to the requirements of the New York Insurance Department regarding *casualty* companies was that it required claimant to maintain reserve funds to meet "all of its accrued but unpaid indebtedness."

The Finding with respect to the Insurance Department of Massachusetts was that it required

claimant to hold or reserve assets for the payment of "all claims and obligations against it," and with respect to the requirements of the Wisconsin Department, that it authorized the commissioner of insurance in computing the reserve liability of *casualty* companies, "to make such computations as in his judgment are equitable and just," and that he has "required claimant to carry sufficient reserves to cover all of its outstanding liabilities."

With respect to the claims under the rulings of the insurance departments of Pennsylvania, New York, and Wisconsin, however, and the contention of the claimant that it was required to provide reserves for the payment of the rejected items of liability, this Court said:

> Whether this contention of the claimant can be justified or not depends upon the meaning which is to be given to the words "reserve funds" in the two acts of Congress we are considering.
>
> The term "reserve" or "reserves" has a special meaning in the law of insurance. While its scope varies under different laws, in general it means a sum of money, variously computed or estimated, which, with accretions from interest, is set aside, "reserved," as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, future unaccrued and contingent claims, and claims accrued, but contingent and indefinite as to amount or time of payment.

In this case, as we have seen, the term includes "unearned premium reserve" to meet future liabilities on policies, "liability reserve" to satisfy claims, indefinite in amount and as to time of payment, but accrued on liability and workmen's compensation policies, and "reserve for loss claims" accrued on policies other than those provided for in the "liability reserve," but it has nowhere been held that "reserve," in this technical sense, must be maintained to provide for the ordinary running expenses of a business, definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance, and unpaid brokerage.

The requirements relied upon, of the Insurance Departments of New York, Pennsylvania, and Wisconsin, that "assets as reserves" must be maintained to cover "all claims," "all indebtedness," "all outstanding liabilities," in terms might include the rejected items we are considering; but plainly the departments, in these expressions, used the word "reserves" in a non-technical sense as equivalent to "assets," as is illustrated by the Massachusetts requirement that each company shall "hold or reserve assets" for the payment of all claims and obligations. The distinction between the "reserves" and general assets of a company is obvious and familiar, and runs through the statements of claimant and every other insurance company.

From this the conclusion is plain that the Act of Congress permitting a deduction of a reserve "required by law" applies only to such reserve as "has a special meaning in the law of insurance"; that the Pennsylvania statute requires casualty companies to maintain such a "loss claims reserve," but that the laws of Pennsylvania and the other states, including New York, though requiring assets as reserves, or "reserve funds," to be kept sufficient to cover all outstanding obligations of the company, do not permit deduction to be made under the Federal Statute except to the extent to which these funds are properly and actually "reserves," within the meaning of the insurance term, no matter how they may be described in the forms upon which reports are made.

Considered in the light of the distinction between the business of fire insurance companies and casualty companies, and the difference in the laws respecting the reserves of these companies, there is no inconsistency between the *McCoach case* and the *Maryland Casualty Company case,* and there is nothing in the opinion in the *Maryland Casualty case* to indicate that the Court intended to overrule or question the authority of the *McCoach case.* The loss claims reserve of a *fire* insurance company is not deductible under the Federal law, because it is not a reserve in the ordinary sense of the word and is not so treated in the

State Insurance Laws. The loss claims reserve of a *casualty* company, however, is deductible because it is in fact a reserve in the ordinary sense of the word and is so recognized by the State Insurance Laws.

III

The judgment appealed from will result in the allowance to the appellee of a double deduction

From Finding XI of the Court of Claims, page 10, it appears that the books of the plaintiff were kept on the written or accrued basis, and its reports to State insurance departments were made on the same basis. Plaintiff's returns to the Commissioner of Internal Revenue were made on a cash basis until 1920, when the Commissioner, on the authority of Section 13 (d) of the Revenue Act of September 8, 1916, c. 463, 39 Stats. 756, 771, required returns to be made on the written or accrued basis beginning with the year 1916, and thereafter plaintiff's returns theretofore filed were amended by the Internal Revenue Bureau so as to conform to the written or accrued basis. From this the inference might fairly be drawn that the losses actually accrued during the year, represented by these so-called "reserves," and liabilities accrued on policy and annuity contracts have been allowed. However, as that result does not appear with absolute definiteness the parties have filed a stipulation that a certain fact may be considered by the court,

which fact was stipulated by them in the court below and which both parties asked the Court of Claims to find. The stipulation is that there be added to Finding XI of the Court of Claims the following:

> In this adjudication, the accrued policy losses for the year 1916, exclusive of the losses incurred but not reported, were deducted from gross income in arriving at the claimant's net income. These accrued policy losses so deducted included losses represented by the sum of $560,678.43, the net addition made by claimant during the year 1916 to its loss claims reserve fund as required by the Superintendent of Insurance of the State of New York, which is the amount of deduction here in dispute.

Should this court be willing to consider this fact thus stipulated by the parties it is, we think, apparent that the affirmance of this judgment will result in allowing to the plaintiff the deduction of the same sum twice, once on the theory of a reserve and once upon the theory of an accrued loss. Should the court be unwilling to accept the stipulation, then the parties have in the alternative moved to remand the case to the Court of Claims for the purpose of having the fact found.

It must be remembered that the Revenue Act of 1913 did not permit corporations to render a return upon an accrual basis. Section 13(d) of the Revenue Act of 1916 changed this by permit-

ting returns to be made upon that basis. When insurance companies kept their books and filed their statements with insurance departments upon an accrual basis, but reported their incomes to the Internal Revenue Department upon a cash basis, it is easy to see that a certain amount of inconsistency would necessarily result, and, as suggested by this court in the *Maryland Casualty Company case,* it is not difficult to suggest conditions under which, by the terms of the statute itself, a double deduction might properly follow. When the law was changed, however, so as to permit corporations to file returns upon an accrual basis and thereby obtain a deduction for all losses sustained but unpaid, it is inconceivable that Congress under such conditions intended to allow a deduction both for the loss sustained and amount "reserved" on account of that loss.

CONCLUSION

THE JUDGMENT OF THE COURT OF CLAIMS SHOULD BE REVERSED.

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ALFRED A. WHEAT,
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SEPTEMBER, 1925.